City of Detroit

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TO: The Honorable Detroit City Council

FROM: David Whitaker
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DATE: February 24, 2006

RE: **PROPOSED WATER AFFORDABILITY PLAN**

This memorandum serves as the Research and Analysis Division's (RAD) response to this Honorable Body's request for an opinion regarding the correspondence from Spiegel & McDiarmid that discusses legal issues relative to Roger Colton's proposed water affordability plan.

BACKGROUND

In January 2005, Roger Colton (Fisher Sheehan and Colton – Public Finance and General Economics) submitted a water affordability proposal to Council that had been presented to the Detroit Water and Sewerage Department (DWSD) on behalf of the Michigan Poverty Law Program, Michigan Legal Services, and their respective clients. The proposal (hereinafter referred to as the "Colton Report") contains the following recommendations:

- Adoption of a rate affordability program consisting of a rate discount component, an arrearage management component, and a water conservation component;
- Adoption of designated fundamental consumer protections involving late fees, service disconnections, and payment plans; and
- Adoption of designated collections initiatives directed toward customers having an "ability-to-pay".

The water affordability program, which would serve to benefit and be paid for by Detroit customers, is based on the following eligibility requirements. In order to qualify for the reduced rate, the household must be at or below 175% of the Federal Poverty Level and the household water and sewerage burden must exceed the level deemed affordable[1]. The customer's payments would also be based on a sliding scale that is tied to a percentage of income:

Below 50% of poverty - 2%
50 - 100 % of poverty - 2.5%
100 - 175% of poverty - 3.0%

Assuming a 40% participation rate, the total estimated annual cost would be $13,515,916 with a "meters charge" assessment as the cost recovery mechanism[2]. On an annual basis, Detroit customers would pay the following fees:

Customer	Annual Meters Charge	Total Revenue
• Residential	$12	$3,125,268
• Commercial	$240	$3,883,680
• Industrial	$3,300	$4,969,800
• Municipal	$900	$459,000
• School	$900	$528,300
• Housing	$900	$550,800

Total revenue:	$13,516,848
Total program cost:	$13,515,916
Annual excess (shortfall)	$932

In addition to the water affordability component, the Colton Report contains several collection initiatives and administrative measures that, if adopted, would serve to rationalize the overall collections process and ultimately curb the massive number of yearly shut-off notices. Mr. Colton contends that DWSD's adoption of the water affordability proposal would not only address persistent affordability problems facing low-income Detroit residents but also generate savings through the implementation of administrative procedures designed to streamline the collection process.

[1] The burden of a water/sewerage bill is measured as a percentage of income. Mr. Colton uses 2% as an affordable water burden and goes on to state that if a low-income Detroit residential water/sewerage bill is $536 per year, that amount would represent a water burden of 8.1% for a Supplemental Security Income (SSI) household receiving a monthly income of $552, and 9.7% for a three-person household receiving $459 per month in Temporary Assistance of Needy Families (TANF) benefits.

[2] According to Mr. Colton, of the 260,000 DWSD residential customers, approximately 43% have incomes at or below 175% of the Federal Poverty Level. The water affordability program budget is based on a 40% participation rate.

The proposed collection initiatives are as follows:

- Increased use of electronic funds transfer protocols for payment plans by customers with the "ability-to pay";
- Increased use of receiverships for rental housing as a means to collect overdue landlord utility bills; and
- Increased use of "cross-servicing" or coordination of residential and non-residential accounts with other municipal offices, which should result in a substantial collection advantage.

ANALYSIS OF THE BOLT DECISION

In response to Council's request for an opinion regarding the Colton Report, the Law Department, relying on *Bolt v City of Lansing* 459 Mich. 152; 587 N.W. 2d 264 (1998), concluded that "Michigan law requires that municipal water and sewage rates must be based on the cost of service. DWSD cannot charge some Detroit residents less than the cost of service and raise the rates paid by its non-low income and suburban customers[3] to provide a financial subsidy to low-income residents."

It is important to note the irony embedded in the Law Department's analysis. On one hand, the Law Department rejects the affordability proposal on the grounds that the fees associated with the program exceed the cost of service. At the same time, DWSD, during its recent presentation to Council, admitted that if the "**collection rate is not improved, City of Detroit customers will see significant rate increases**". (See attached). Simply put, the sustained inability of low-income customers to pay for the service will result in increased costs associated with the collection of delinquent accounts. If left unresolved, the increased administrative costs will be passed on to the customers as a cost of service. Using that analysis, one could certainly argue that the lack of affordable water will, likewise, have a direct impact on the cost of service.

At the request of the Michigan Poverty Law Program, Sean Flynn, Esq. of Spiegel & McDiarmid responded to the Law Department's opinion and reached the following conclusions regarding the *Bolt* decision:

- the Board of Water Commissioner's rates are user fees, not taxes, and therefore not subject to the Headlee Amendment, and

[3] Contrary to the Law Department's repeated assertions, the Colton Report, at page 3, states that "[w]hile DWSD provides some service to communities outside Detroit, this proposal is confined to the City of Detroit only".

- even if the fees were taxes, the cross subsidies are authorized by legislation predating the Headlee Amendment and therefore are not subject to its strictures[4].

In order to determine whether the water affordability proposal is a fee or a tax, both the Law Department and outside counsel reviewed the *Bolt* decision, which arises out of the following circumstances.

During periods of heavy precipitation, the City of Lansing's combined wastewater disposal system often overflowed and discharged storm water and untreated or partially treated sewage into the Grand and Red Cedar Rivers. In an effort to comply with the Clean Water Act and the National Pollutant Discharge Elimination Standards permit requirement to control Combined Sewer Overflow (CSO), Lansing elected to separate its remaining combined sanitary and storm sewers.

In 1995, the Lansing City Council adopted Ordinance 925, which provides for the creation of a storm water enterprise fund[5] to help defray the cost of the administration, operation, maintenance, and construction of the storm water system[6]. Pursuant to the Ordinance, "the costs for the storm water share of the CSO program (fifty percent of total CSO costs, including administration, construction, and engineering costs) will be financed through an annual storm water service charge. This charge is imposed on each parcel of real property located in the city using a formula that attempts to roughly estimate each parcel's storm water runoff[7]".

The city of Lansing began billing property owners for the storm water service charge in December 1995, with payment due in March 1996. Plaintiff (who was billed $59.83 for his 5,400 square-foot parcel) filed a lawsuit alleging that Ordinance 925 violated the Headlee Amendment (Michigan Constitution 1963, Article IX, Section 31). The Court of Appeals held that the storm water service charge did not violate the Headlee Amendment because it constituted a valid user fee. Relying on the *Ripperger v Grand Rapids* decision 338 Mich. 682; 62 N.W. 2d 585 (1954), the Court concluded that sewage disposal charges to landowners are not a tax.

The Michigan Supreme Court granted leave to appeal to determine whether the storm water service charge imposed by Ordinance No. 925 was a valid user fee or a tax that violated the Headlee Amendment. The Court held that the storm water service charge was a tax, for which approval was required by a vote of the people pursuant to the Headlee Amendment.

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[4] Further, Mr. Flynn argues that the "proposed cross subsidy also meets the criteria for a valid 'regulatory' fee."

[5] The fund replaced that portion of the system that was previously funded by general fund revenues secured through property and income taxes.

[6] The cost of implementing the combined sewer overflow control program was estimated at $176 M over a period of thirty years.

[7] Additionally, the charge was applied to all property owners, not just those who benefited from the system.

In determining whether the storm water service charge was fee or a tax, the Supreme Court considered the following criteria:

- whether the user fee serves a regulatory purpose rather than a revenue-raising purpose;
- whether the fees are proportionate to the necessary costs of the service; and
- whether the user fee is a payment for the voluntary receipt of a measured service, in which the revenue from the fees are used only for the service provided (i.e. voluntariness).

With regard to the third criterion, the Court cited the following example from *Jones v Detroit Water Commissioners,* 34 Mich. 273 (1876):

> The water rates paid by consumers are in no sense taxes, but are nothing more than the price paid for water as a commodity, just as similar rates are payable to gas companies, or to private water works, for their supply of gas or water.

Recognizing the lack of clarity in this area, the Court affirmatively stated:

> **there is no bright-line test for distinguishing between a valid user fee and a tax that violates the Headlee Amendment.** As noted by the Court of Appeals, the difficulty in resolving the issue is that the Headlee Amendment[8] fails to define either the term 'tax' or 'fee', an omission that the Headlee Blue Ribbon Commission urged the Legislature to rectify. (citations omitted)

Generally speaking, a "'**fee**' is 'exchanged for a service rendered or a benefit conferred, and some reasonable relationship exists between the amount of the fee and the value of the service or benefit.' *Saginaw Co, supra* at 210; *Vernor v Secretary of State,* 179 Mich. 157, 164, 167-169; 146 N.W. 338 (1914). A '**tax**,' on the other hand, is designed to raise revenue. *Bray v Dep't of State,* 418 Mich. 149, 162; 341 N.W. 2d 92 (1983)." (emphasis added).

In reviewing the overall goal of the storm water service charge, the Supreme Court in *Bolt* found that the **revenue** to be derived from the charge exceeded the direct

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[8] By way of background, the Headlee Amendment was designed to "limit legislative expansion of requirements placed on local government, to put a freeze on what they perceived was excessive government spending, and to lower their taxes both at the local and state level". *Airlines Parking, Inc. v. Wayne County,* 452 Mich. 527; 550 N.W. 2d 490 (1996).

and indirect costs of actually using the storm water system over the thirty year period and, therefore, constituted a **tax**.

CONCLUSION

The Colton Report seeks to address persistent affordability problems facing 40% of Detroit residents, which in turn will streamline the collection process, and reduce the number of yearly shut-off notices. The Law Department's analysis fails to consider that the ultimate goal is to provide affordable water to low-income Detroit residents who have incomes at or below the poverty level, not to raise revenue. Moreover, the proposal would apply solely to Detroit residents and should not affect DWSD's suburban customers.

Application of the *Bolt* decision to the present facts reveals that the proposed water affordability plan appears to be reasonably related to the cost of providing the service. For that reason, RAD concurs with the Spiegel & McDiarmid opinion, which concludes that the proposed water rates are user fees, not taxes.

Attachment

Conversion to Monthly Billing

- Lower, more regular bills to customers
- Ability to better react to billing anomalies
- More uniform revenue stream to DWSD
- Improved collection rate
  - ✓**IF COLLECTION RATE IS NOT IMPROVED, CITY OF DETROIT CUSTOMERS WILL SEE SIGNIFICANT RATE INCREASES**